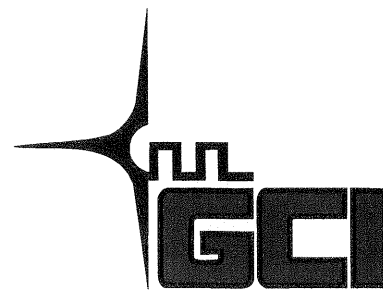


January 24, 2003



Mr. William Maher  
Chief, Wireline Competition Bureau  
Federal Communications Commission  
445 12<sup>th</sup> Street, S.W.  
Washington, DC 20554

Re: CC Docket Nos. 01-338, 96-98, 98-147, 01-318, 98-56, 98-141

Dear Mr. Maher:

I am writing on behalf of General Communication, Inc. ("GCI")<sup>1</sup> to respond to recent ex parte submissions by Alaska Communications Systems Group, Inc. and its operating subsidiaries, ACS of Alaska, Inc., ACS of Anchorage, Inc., ACS of Fairbanks, Inc., and ACS of the Northland, Inc. (collectively "ACS"), in which ACS asks the Commission to restrict, or even eliminate, ACS' unbundling obligations in "markets where there are high levels of retail competition, such as Alaska."<sup>2</sup> GCI recently wrote to you to describe the impairment caused by ACS' discriminatory provision of UNEs, which is well grounded in fact and has been verified by the Regulatory Commission of Alaska ("RCA").<sup>3</sup> The purpose of this letter is to respond to ACS' further assertions that any continuing obligation to provide competitive local exchange carriers ("CLECs") with unbundled network elements ("UNEs") at allegedly below cost rates is unnecessary and will drive ACS out of business.

Rather than serving as a basis to terminate ACS' unbundling obligations, the success of GCI in Alaska proves that the Telecommunications Act of 1996 (the "Act") *is working* to create competition and retail consumer choices, notwithstanding ACS' continued control of bottleneck loops and the ability to connect to those loops. GCI's market share provides no justification for eliminating ACS' unbundling obligations. These competitive inroads would not be possible without GCI's continued access to UNEs – especially unbundled loops, but also unbundled switching and transport. Without

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<sup>1</sup> GCI is a facilities-based CLEC that serves both residential and business customers in Alaska. GCI uses several methods to serve its customers: some customers are served entirely over GCI's own loops (e.g., 22 buildings in Anchorage are served via GCI's fiber ring); many customers are served via UNE loops, in combination with GCI-provided switching and transport; and other customers are served via UNE-P and total service resale.

<sup>2</sup> Letter from Karen Brinkmann, Latham & Watkins, LLP, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, 98-147 (filed January 6, 2003), Letter from Karen Brinkmann, Latham & Watkins, LLP, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, 98-147 (filed January 7, 2003), and Ex Parte Notice, Karen Brinkmann, Latham & Watkins, LLP, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, 98-147 (filed January 16, 2003). ("ACS January 6 ex parte letter," "ACS January 7 ex parte letter," and "ACS January 16 ex parte letter," respectively)

<sup>3</sup> Letter from Frederick W. Hitz, III, GCI, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, 98-147 (filed January 23, 2003). ("GCI January 23 ex parte letter").

unbundling and local competition, consumer choice in Alaska would be virtually non-existent. In fact, as discussed in GCI's January 23 *ex parte* letter,<sup>4</sup> ACS' recent submissions confirm that its substandard and discriminatory provision of UNEs – which the RCA has now confirmed are occurring in violation of the Act and FCC rules – significantly impairs GCI's ability to use its own facilities. ACS notably does not provide any evidence to demonstrate that its bottleneck control over ubiquitous loops – the most fundamental barrier to entry that forces CLECs to rely on UNEs (including switching) in the first place – has been eliminated in Alaska. And, while GCI is investing in IP-based cable telephony, that technology is not yet ready for full-scale commercial deployment, as the Commission recently found in its *AT&T/Comcast Merger Order*. IP-based cable telephony will eventually provide a facilities-based competitive alternative for those customers passed by cable plant (which notably does not include many business customers), but that alternative is not a reality today.

Just as significantly, ACS' pleas that allegedly below-cost UNE rates will lead to the company's insolvency are not grounded in fact. ACS' own SEC financial reports demonstrate that even as ACS has seen a significant loss of retail customers to GCI's UNE-based offerings, ACS' telephone company operating revenues have *increased*. Competition works just as economists would predict: as monopolists are challenged, they must respond and tailor their offerings more to the consumers' desires. As prices fall, particularly for vertical features, and marketing packages improve, more consumers buy these features than during the monopoly era. As demand grows, the pie expands. Like AT&T during the advent of long distance competition, ACS is losing retail market share, but increasing total telephone company operating revenue.

ACS' attempts to conjure up fears of a UNE-caused, ILEC "death spiral" are nothing but smoke-and-mirrors. UNE rates are not the cause of ACS' self-proclaimed precarious fiscal health. As described by the attached report, although ACS' revenues from its regulated telephone operations are increasing, it is losing money in its unsuccessful (and unregulated) long distance, wireless and Internet businesses. ACS also is hemorrhaging cash from interest payments on its substantial debt. This debt was incurred when its investors borrowed heavily to finance a leveraged buyout in which they paid a \$250 million more than book value for the telephone companies even though it is a basic ratemaking principle that such acquisition premiums cannot become part of the regulated ratebase. Yet, ACS and its investors closed the acquisitions after GCI entered the Anchorage market and the Alaska Superior Court had reversed and remanded the Alaska Commission's earlier decision to keep GCI out of the Fairbanks and Juneau markets.<sup>5</sup> In short, ACS' financial performance is the result of the company's

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<sup>4</sup> *Id.*

<sup>5</sup> When GCI first petitioned the then-Alaska Public Utility Commission ("APUC") to lift the Section 251(f) "rural exemption" for ACS-predecessor CenturyTel's Fairbanks and Juneau study areas, the APUC declined to do so. APUC Order U-97-82/143/144(2) (March 8, 1998). In March 1999, the Alaska Superior Court reversed the APUC's determination, holding that the APUC had inappropriately assigned the burden of proof to GCI. Decision and Order, *General Communication, Inc. v. Alaska Public Utilities Commission*, Superior Court Case No. 3AN-98-04759/04903/04905 CI. (March 4, 1999). ACS closed its acquisitions of the CenturyTel properties, including Fairbanks and Juneau, as well as its acquisition of the Anchorage Telephone Utility in May 1999. ACS 10-K (dated March 29, 2002). In June 1999, acting on remand, the APUC granted GCI's petition to lift the "rural exemption" for ACS' Fairbanks and Juneau systems. Order U-97-82(9)/U-97-143(9)/U-97-144(9) (June 28, 1999). That order was subsequently reaffirmed in October 1999 by the

own poor business decisions in a “classic case of a leveraged buyout gone bad,”<sup>6</sup> not the regulatory policy applicable to its operating companies.

**I. ACS’ Proposal, If Adopted, Will Restrict Or Even Eliminate Competition in the Nation’s Most Competitive State.**

ACS asks the Commission to grant it relief from the unbundling and related pricing obligations in the Act on the basis that GCI’s growing share of the retail market—which is about 40 percent of the retail access lines in Anchorage—somehow demonstrates that GCI no longer will be impaired without access to UNEs. ACS also justifies its request for a special form of relief on the grounds that “the Commission must establish relief from unbundling requirements that is specific to the markets served by non-BOC ILECs, to satisfy the D.C. Circuit’s mandate that the Commission identify with specificity when a particular CLEC in a particular market would not be ‘impaired’ by the lack of access to one or more UNEs.”<sup>7</sup> GCI agrees that the Commission must take a granular approach using recognized economic techniques of competition analysis to determine whether a CLEC would be impaired without UNEs. However, as discussed below, ACS proposes market-specific unbundling requirements for itself without justifying these obligations on market-specific differences that affect a CLEC’s level of impairment without UNEs.

**A. ACS Confuses Retail Market Share and Impairment.**

GCI previously explained that it is impaired without access to UNEs at TELRIC-based rates, particularly loops, transport and switching.<sup>8</sup> ACS provides no evidence to refute this fundamental fact with respect to the UNE inputs it supplies to other carriers. Instead, ACS simply asserts that it should no longer be required to provide CLECs such as GCI with access to UNEs in “highly competitive markets,” and proposes specific triggers based on a competitor’s share of the *retail* market to determine when its unbundling obligations should sunset.<sup>9</sup> ACS’ proposals are shams, and lack any economic basis. A CLEC’s ability to obtain *retail* customers, even in significant numbers, does not mean that the CLEC has a choice in its supplier of inputs, including self-supply. GCI has gained a large share of the Anchorage retail local telephone market, but GCI is almost wholly dependent on ACS to provide unbundled loops. ACS’ power in the market for loops is virtually undiminished from the days before competition.

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Regulatory Commission of Alaska, which was the successor to the APUC. Order U-97-82(11)/U-97-143(11)/U-97-144(11) (October 11, 1999).

<sup>6</sup> See, “The Financial Condition of Alaska Communications Systems Group, Inc. Phase I Report,” Snavelly King Majoros O’Connor & Lee, Inc. at 2 (“Snavelly King Report”) a copy of which is attached to this letter as Exhibit A.

<sup>7</sup> ACS January 6 ex parte letter at 3 and ACS January 16 ex parte letter at 3.

<sup>8</sup> GCI November 12 ex parte letter and GCI January 23 ex parte letter.

<sup>9</sup> ACS January 6 ex parte letter at 13.

Congress expressly recognized that retail market competition is not the standard by which the Commission determines whether an ILEC must comply with the unbundling obligations in the Act. Section 251(d)(2)(B) requires the Commission to consider whether “the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services it seeks to offer.”<sup>10</sup> Congress expressly recognized that UNEs are inputs into a CLEC’s provision of retail telecommunications services. What must be impaired is the CLEC’s ability to provide its retail service in the absence of the ILEC-provided UNEs. The statutory impairment test therefore requires evaluation of the CLEC’s alternative sources of the *input*, not the consumer’s alternative sources of the *output*. ACS’ proposal to sunset UNEs based on the consumer’s alternatives in the output market, rather than the CLEC’s alternatives in the input market therefore violates the plain language of Section 251(d)(2)(B).

ACS has not demonstrated that there is an existing alternative source of supply from which GCI can obtain UNEs. The simple facts demonstrate otherwise. Today in Anchorage, Alaska, even though GCI has a substantial share of the retail market, *GCI still serves less than 7 percent of its outside loops entirely over its own facilities.*<sup>11</sup> ACS is therefore incorrect when it asserts that “the bargaining power between GCI and ACS has shifted in GCI’s favor” based on GCI’s growth in the retail market.<sup>12</sup> GCI has no power in the wholesale market for UNEs, which is the relevant market to examine under Section 251(d)(2)(B).

Moreover, even when GCI’s network passes a retail customer, such as the large businesses in one of the 22 office buildings in Anchorage served by GCI’s fiber ring, it is very difficult to obtain access to other buildings that GCI’s ring passes. Several carriers, including GCI and WorldCom, have already documented the significant difficulties a competitive carrier faces when trying to obtain access to multi-tenant buildings, such as the cost and delay associated with trying to negotiate access to conduit, either with a reluctant landlord or the ILEC.<sup>13</sup> Often, building access erects such a substantial barrier that GCI is forced to lease facilities from the ILEC – bypassing the facilities GCI has already

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<sup>10</sup> 47 U.S.C. § 251(d)(2)(B).

<sup>11</sup> This excludes the voice grade equivalents for customers collocated in GCI’s switching centers, because these “loops” never run outside the switching center. In fact, ACS’ assertion that GCI “is currently providing service over its own facilities for approximately 27% of the lines it serves in its market,” (ACS January 6 ex parte letter at 5) which is based on a vague reference to some unidentified GCI financial report, substantially overstates the number of lines GCI serves over its own outside plant.

<sup>12</sup> ACS also makes the unsupported assertion that GCI is “raising rates in its monopoly cable business, while pricing retail telephone services at below ACS’ incremental cost to provide the UNE loop over which these services are provided.” ACS January 6 ex parte letter at 4. No reasonable firm would engage in such a strategy because the firm does not have the ability to recoup its short-term losses in the long run. Specifically, GCI would not use profits from a stable line of business (cable) to subsidize predatory pricing activities in a highly competitive line of business (local telephony). This is because GCI has little chance of recovering its short-term losses in this market. Even if GCI could drive ACS out of business (which is not GCI’s strategy) some other firm would purchase ACS’ highly valuable telephone plant in a bankruptcy auction. In short, GCI would always face a competitor using ACS’ legacy network.

<sup>13</sup> “Building Access Issues Presented in the UNE Triennial Review,” attachment to Letter of Ruth Milkman, Lawler, Metzger & Milkman, LLC, to Marlene Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, 98-147 (filed October 25, 2002) and GCI November 12 ex parte letter at 8.

installed – because this is the only means to reach the customer. In fact, building access and the related issue of access to rights-of-way have been identified as inherent “first mover” advantages that necessitate CLEC access to UNEs.<sup>14</sup> A retail market share test, such as ACS proposes, would never acknowledge these real world sources of impairment that are captured by Section 251(d)(2)(B)’s express language.

GCI generally serves the remainder of its customers using one of three methods of entry: UNE loops in combination with GCI-provided switching and transport, UNE-P, or total service resale. Even with all the investment it has made in its own fiber ring, switches, collocation, concentration equipment and other facilities, GCI still requires access to ACS’ outside loop plant for more than 93 percent of its customers’ lines. There are two reasons for this. First, GCI cannot build a loop to serve every one of its customers given high sunk costs and GCI’s limited economies of scale and scope.<sup>15</sup> This impairment is exacerbated by “first mover” advantages that only ILEC’s like ACS enjoy, such as favorable rates, terms and conditions for access to multi-tenant buildings and rights-of-way. Second, GCI cannot purchase loops from a third-party provider, because ACS is the only LEC that owns transmission facilities to every customer premise in the Alaska markets in which GCI operates. In the absence of the ability to build or buy, GCI must rely on UNE loops.

Moreover, even though GCI also owns a transport ring that connects the ILEC central offices in Anchorage, Fairbanks and Juneau with GCI’s own switches in those areas, GCI will still be impaired without access to unbundled transport at TELRIC-based rates. As GCI adds collocation sites, particularly in the Fairbanks/North Pole and Juneau markets, to allow GCI to use its own switch and transport facilities, in some cases GCI will need to purchase trunks to reach those collocation sites (whether these trunks are called transport or sub-loop feeder) in instances where building its own facilities would be cost prohibitive. In these areas, GCI is impaired without access to ACS unbundled feeder/transport because there is no other source of feeder/transport to these concentrators. Given that a substantial number of which these remote concentrators serve less than 1,000 total lines,<sup>16</sup> GCI will never be able to recover the expense of building its own facilities to these locations. In fact, several commenters in this proceeding have explained how the geographic dispersion of residential and small business customers prevents a CLEC like GCI from achieving the economies of scale and scope

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<sup>14</sup> Letter from Robert H. Bork to Michael J. Powell, Chairman, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, 98-147 at 6 (filed January 10, 2003) (“Bork letter”) discussing three basic categories of impairment—economies of scale and scope, sunk costs, and other entry barriers, such as first mover advantage—that the Commission could consider as it interprets Section 251(d)(2)’s impairment standard in the wake of the D.C. Circuit Court of Appeals decision in *USTA v. FCC*, 290 F.3d 415.

<sup>15</sup> Indeed, even the RBOCs recognize the fundamental impairment CLECs face without access to voice-grade loops, and have not sought to eliminate these facilities from the national list of unbundled network elements. ACS has not provided any basis, other than its loss of market share, to justify the elimination of UNE loops in Alaska.

<sup>16</sup> See GCI January 23 ex parte letter, Exhibit B, which shows the number of ACS access lines served out of each switching center, including ACS’ central offices and remote terminals.

required to serve customers via self-deployed facilities, thereby requiring the CLEC to obtain unbundled transport and in many circumstances, unbundled local switching, from the ILEC.<sup>17</sup>

Finally, in some instances, GCI relies on UNE-P. As discussed in GCI's previous filings in this docket, when GCI wins a customer served from a non-GR-303-capable remote terminal, GCI cannot access the customer's UNE loop and can only utilize UNEs to serve that customer via UNE-P.<sup>18</sup> In Fairbanks/North Pole, 29% of ILEC loops cannot be accessed through the ACS central office or one of the other remote sites at which GCI has collocated; in Juneau, 52% of ILEC loops cannot be accessed from GCI's collocation at the ACS central office. In these markets, GCI is impaired without access to unbundled switching because these customers cannot be served through UNE-L. GCI also relies on UNE-P as a customer acquisition device, eventually transitioning the customer to its own facilities, due to ACS' inability to provision UNE loops in mass quantities. Without access to UNE-P, ACS' network architecture and poor provisioning performance would effectively cap the growth of local competition in Alaska's largest markets. And, rather than refuting these sources of CLEC impairment, ACS actually acknowledges them in its latest *ex parte* filings.<sup>19</sup>

Thus, rather than "fail[ing] to show that it would be 'impaired' in providing the services it seeks to offer if it had to build facilities or purchase them at market prices in arms' length negotiations with ACS,"<sup>20</sup> GCI has in fact made a well-supported case for its impairment without access to UNEs which, unlike ACS' assertions, is grounded in antitrust law and economics. As discussed in GCI's January 23 letter, several learned commentators have identified obstacles which impair a CLEC's ability to deploy its own facilities and therefore permit the CLEC to access UNEs pursuant to Section 251(d)(2).<sup>21</sup> These include economies of scale and scope, high sunk costs, and first-mover advantages/second-mover disadvantages.<sup>22</sup> In fact, scale itself can be a barrier to the deployment of alternative facilities, particularly when it is not economically viable for another carrier to enter and install its own facilities because a particular central office (or remote concentrator) is too small or too far from the carrier's other operations.<sup>23</sup> This is clearly the case with regard to GCI's collocation of DLC equipment and transport facilities used to serve customers in rural areas. In short, these analyses buttress GCI's actual commercial experience, as discussed above. Clearly, it is ACS that has failed to demonstrate that GCI would not be impaired without access to UNEs.

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<sup>17</sup> Letter from Access Integrated Networks et al. to Marlene Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 01-338, 96-98, 98-147 (filed December 11, 2002).

<sup>18</sup> GCI November 12 *ex parte* letter and GCI January 23 *ex parte* letter.

<sup>19</sup> ACS January 6 *ex parte* letter at 6-9.

<sup>20</sup> ACS January 16 *ex parte* letter at 2.

<sup>21</sup> GCI January 23 *ex parte* letter at 4-5.

<sup>22</sup> *Id.*, citing Bork letter at 2.

<sup>23</sup> *Id.* citing Dr. Robert Willig, "Determining 'Impairment' Using the *Horizontal Merger Guidelines* Entry Analysis," at 5, attached to Letter of Frank Simone, AT&T, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket No. 01-338 (filed November 18, 2002).

To effectuate its request for relief, ACS has proposed “triggers” that will exempt smaller, non-Regional Bell Operating Company (“RBOC”) ILECs from the unbundling requirements of Section 251. Based on the foregoing commercial realities, it is quite clear that these triggers in no way measure whether a CLEC will be impaired without access to UNEs. Instead, the triggers would eliminate UNE access at TELRIC-based rates once a CLEC achieves certain facilities-deployment or market-share levels, without considering the impairment that requires the CLEC to obtain UNEs from the ILEC in the first place. The unfortunate result of these proposed triggers, for which ACS provides no economic or technical support, would be to eliminate all of the local competition gains that new entrants and retail customers have enjoyed to date.

**Market share trigger.** ACS asks the Commission to amend its rules so a non-RBOC ILEC will be exempt from the obligation to provide UNEs with respect to a CLEC providing telecommunications exchange service or exchange access to subscribers of 25 percent or more of the subscriber lines installed (or 25 percent of the local exchange revenue base) in the carrier’s service area.<sup>24</sup> As an alternative, the ILEC would be required to provide UNEs, but the CLEC would negotiate market-based rates. GCI has already explained that a CLEC’s retail market share has no effect on its impairment without access to UNEs. It is GCI’s ability to purchase unbundled loops that has enabled GCI to achieve a significant market share in ACS’ service areas. Without access to UNE loops, GCI’s market share would drop precipitously. Of course, that is the goal of ACS’ proposal.

**Collocation trigger.** ACS also asks the Commission to relieve it from its Section 251(c) unbundling obligations with respect to a CLEC that has collocation with competitive transport in 50 percent of wire centers or in wire centers accounting for 65 percent of the revenue from the ILEC’s local exchange services.<sup>25</sup> Once again, ACS provides no evidence showing that a CLEC’s collocation arrangements are a reasonable proxy for the impairment the CLEC will face without access to ILEC UNEs, particularly unbundled loops. A CLEC’s collocation arrangement is worthless if the CLEC cannot use this investment to access UNE loops at TELRIC-based rates, given that in almost all circumstances it is infeasible for a CLEC to construct its own loops and there is no alternative source of supply. In fact, eliminating access to UNEs will effectively strand the substantial investment that GCI has made in its own switching and transport.

**Consumer choice trigger.** Finally, ACS asks the Commission to grant it relief from the Section 251 unbundling requirements in those markets where consumers have a choice among multiple facilities-based local exchange carriers.<sup>26</sup> “Facilities-based local exchange carrier” is defined as a CLEC that provides telecommunications services using its own switching capability.<sup>27</sup> This proposed trigger, like ACS’ other triggers, in no way considers a competitor’s impairment without access to UNEs. Moreover, such a policy is antithetical to this Commission’s goal of promoting facilities-based

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<sup>24</sup> *Id.* at 13 and ACS January 16 ex parte letter at 3.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

competition, because it discourages CLECs from deploying their own switches and limits new entrants to entry methods such as UNE-P and total service resale.

ACS has made no attempt to develop triggers that consider the sources of CLEC impairment which require ACS to provide UNEs under the Act. Instead, ACS has formulated a set of requirements which, if imposed, would not only eliminate its principal competitor's ability to compete, but would force GCI to terminate service to many of its existing customers. This would be a disastrous outcome in the nation's most competitive state. GCI recently described the consumer welfare benefits that are available when CLECs have access to cost-based UNEs.<sup>28</sup> UNE-based competition allows competitors to set their prices independent of the ILEC, which in turn creates meaningful price competition that benefits consumers. For example, when the RCA simultaneously approved a 24 percent retail rate increase for ACS of Anchorage, Inc. and an interim and refundable increase in UNE loop rates in November 2001, GCI held the line and did not follow ACS of Anchorage's subsequent retail rate increases. As a result, consumers flocked to GCI. Without access to UNEs, GCI will not have the ability to engage in real price competition with the incumbent. This means that Alaska consumers—whether they switch to GCI or maintain service with ACS—will lose the benefit of lower rates.

## **B. Cable Telephony Is Not Yet A Substitute for UNEs.**

GCI plans eventually to provide IP-based telephony services to Alaska consumers by upgrading its existing cable plant. This will allow GCI to achieve greater margins and avoid the significant costs incurred from dealing with a supplier that also happens to be its main competitor. Today, however, IP-based cable telephony is a nascent technology. GCI has an ongoing field test of IP-based cable telephony, and assuming acceptable results, will begin to upgrade portions of its network this summer so that a gradual commercial deployment may begin in 2004. At the presently expected cost levels, IP-based cable telephony is more economically attractive than leasing UNE loops from ACS. As such, the Commission should ignore ACS' assertion that GCI has slow-rolled its deployment of cable telephony because "it is much more economic to get access to customers via below-cost UNEs than it is to incur the costs of actually building facilities to its customers."<sup>29</sup> GCI has every incentive to move its customers to its own network as soon as possible, but this transition is not likely to begin until 2004.

There are two technical approaches to providing cable telephony: circuit-switched cable telephony and DOCSIS, IP-based cable telephony. To date, cable providers in the lower 48 states have primarily deployed the former, whereas GCI plans to deploy the latter.<sup>30</sup> This demonstrates the inaccuracy of ACS' assertion that "Any reluctance by GCI to actually deploy cable telephony is not due

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<sup>28</sup> GCI November 12 ex parte letter at 2.

<sup>29</sup> ACS January 6 ex parte letter at 5.

<sup>30</sup> GCI chose an IP-based platform because equipment from different vendors can operate on an IP-based system, whereas interoperability is not available through the circuit-switched technology.

to technical difficulties as approximately 2 million customers in the nation receive this service.”<sup>31</sup> *GCI is deploying an entirely different type of cable telephony.* Many cable providers are interested in upgrading to IP-based systems, but deployment has been delayed while the technology becomes standards-compliant, reliable, and available in commercial quantities.<sup>32</sup>

This Commission itself recently acknowledged that cable telephony is not a viable alternative to the Public Switched Telephone Network (“PSTN”), despite ACS’ assertions to the contrary.<sup>33</sup> As stated in the *AT&T-Comcast Merger Order*, “Cable VoIP, however, is still nascent; although the concept has existed for several years, no cable operator in the United States has yet deployed the technology on a wide-scale basis.”<sup>34</sup> The Commission concluded, “This creates a high level of uncertainty surrounding the pace of cable telephony deployment,” and, in the context of that merger, led the Commission to conclude that public interest benefits from the acceleration of cable telephony deployment were “speculative at best and, therefore, difficult to evaluate.”<sup>35</sup>

Until the IP-based cable telephony becomes a commercially viable alternative, GCI will be forced to rely on access to UNEs at reasonable, TELRIC-based rates. GCI’s need for UNEs will extend beyond 2004 because GCI will need four-to-five years to upgrade all of its systems and transition its customers to IP-based cable telephony. Also, on a long-term basis, GCI will rely on UNE loops for customers in business areas because GCI’s cable plant does not pass these customers. In fact, rather than “impairing the deployment of new technologies and true competition,”<sup>36</sup> access to UNEs will promote the sustainable deployment of facilities by allowing GCI to acquire a customer base from which GCI can recover its substantial capital expenditure. Interestingly, ACS’ assertion that unbundling rules should be eliminated to force GCI to build its own facilities does not promote ACS’ own well-being. In addition to the UNE provisioning problems that GCI has previously described,<sup>37</sup> GCI will achieve much greater margins when it is able to bypass the ILEC altogether. If ACS is interested in maximizing its return, it should fight to keep GCI on its network by providing nondiscriminatory access to reasonably priced UNEs rather than losing all revenue when GCI becomes a pure facilities-based competitor.

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<sup>31</sup> ACS January 6 ex parte letter at 5.

<sup>32</sup> See <http://www.cabledatacomnews.com/nov02/nov-2-4.html>.

<sup>33</sup> ACS January 6 ex parte letter at 5.

<sup>34</sup> Memorandum Opinion and Order, *In the matter of Applications for Consent and Control of Licenses from Comcast Corporation and AT&T Corp., Transferors, to AT&T Corp., Transferee*, MB Docket No. 02-70, FCC 02-130, 75 ¶ 192 (rel. November 14, 2002).

<sup>35</sup> *Id.*

<sup>36</sup> ACS January 6 ex parte letter at 6.

<sup>37</sup> GCI November 12 ex parte letter and GCI January 23 ex parte letter.

### **C. Forbearance From Section 251 Is Procedurally Improper and Would Be Unlawful.**

ACS also asks the Commission to forbear from Section 251(c), and particularly Section 251(c)(3) unbundling requirements because of the *retail* (not wholesale) competition that exists in Anchorage.<sup>38</sup> As discussed above, ACS' request is without merit because the level of retail competition in Anchorage has nothing at all to do with the extent to which GCI would be impaired without access to ACS unbundled loops. Approximately 93 percent of GCI lines in Anchorage that terminate outside GCI's switching center are served over ACS facilities, and no substitute exists today for those facilities. GCI is, in fact, impaired without access to these unbundled loops.

In the first instance, ACS' request is procedurally improper. This docket is a notice of proposed rulemaking regarding the implementation of Section 251, and particularly Section 251(d)(2). The Commission has not given notice of intent to consider forbearing from the enforcement of Section 251(c) and (d) – especially in situations where the requesting carrier is still impaired without access to UNEs.

In raising its forbearance argument, ACS is necessarily asserting that the Section 10 forbearance criteria are met even *if* GCI is impaired without access to unbundled loops. This is simply not the case. Without access to unbundled loops, GCI's facilities-based entry in Anchorage (and the rest of Alaska) would be shut down. The only alternative left to serve 93 percent of GCI's Anchorage lines terminating outside its local switching centers would be total service resale – which is not facilities-based competition and the price of which is directly tied to ACS' retail rates.

In this light, ACS' claims fail to meet the Section 10(a) forbearance tests. First, enforcement of the Act's unbundling requirements is necessary to ensure that ACS will, in fact, provide unbundled loops to GCI and will do so at just, reasonable and nondiscriminatory rates, terms, and conditions. The fact that the RCA has recently held that ACS unjustly and unreasonably discriminates against GCI in its provision of UNEs and services for resale *per se* establishes that Section 10(a)'s criteria are not met.<sup>39</sup> Second, enforcement of the unbundling requirements is necessary for the protection of consumers. If GCI had relied solely on total service resale and had no access to UNEs, when ACS increased its retail rates in Anchorage by 24 percent, GCI would have had to follow because GCI's costs would also have increased 24 percent. Because of access to UNEs, GCI was not forced to follow ACS' price increase, which benefited consumers. Third, forbearance is clearly not in the public interest. With the Commission's focus on the emergence of facilities-based competition, it is inconceivable that it would be in the public interest to shut down the most successful facilities-based

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<sup>38</sup> ACS January 16 ex parte letter at 3-5.

<sup>39</sup> GCI January 23 ex parte letter, citing Order Requiring ACS to Permit Interim Query Access Into MARTENS or Another Appropriate Database, Requiring GCI to Follow ACS' Line Extension Provisions, for Construction of New Facilities, Requiring Filings, and Finding Petition to Modify Hearing Schedule Moot, *In the Matter of the Investigation into Disparities In Service Provided to Customers of a Competitive Local Exchange Carrier and an Incumbent Local Exchange Carrier*, Docket No. U-02-97, Order No. 3 at 4 (December 5, 2002).

residential market entrant in the country, stranding GCI's investment in collocation, switching and transport facilities. Fourth, forbearance will not promote competitive market conditions, but will kill them.

In addition, Section 251(c)(3) has not been fully implemented in Anchorage, which is a specific precondition imposed by Section 10(d) for forbearance from Section 251(c) requirements. As other commenters in this docket have already made clear, Section 251(c)(3) cannot be considered "fully implemented" in the absence of a mature wholesale market for the inputs for which forbearance is sought.<sup>40</sup> There is no wholesale market in Anchorage for any of the UNEs that GCI purchases from ACS. Indeed, GCI's only alternative source of these elements is GCI itself, and GCI is already self-provisioning to the extent it can do so.

ACS' forbearance request is nothing more than a company-specific plea for an unjustified bailout from its own bad business decisions. As discussed further below, local competition is not the source of ACS' financial problems – ACS' problems are of its own making.

## **II. ACS' Financial Integrity Is Not The Result of Regulatory Policy.**

ACS asks the Commission to "lift unbundling rules which threaten ACS with financial disaster," citing its obligation to provide UNEs at TELRIC rates as the source of its financial ruin.<sup>41</sup> ACS describes a "parade of horrors" that will result if it is not relieved from the market-opening obligations of the Act, including decreased investor confidence, network degradation resulting in diminished service quality, threats to universal services, and ultimately—the bankruptcy of ACS. In the process, ACS makes collateral attacks on the depreciation levels set by the RCA. As discussed herein, the Commission should ignore ACS' attempt to blame federal and state regulatory policy for its woes, which are actually the result of its independent business decisions.

### **A. ACS' Telephone Company Revenues Are Increasing, But Its Competitive, Non-Regulated Operations Are Losing Money.**

ACS asserts that, "After five years of competition in Anchorage, ACS' return on investment, excluding directory revenue, is less than two percent (2%) per year and still diminishing."<sup>42</sup> ACS tells this Commission that it is losing money because of allegedly below-cost UNE rates, depreciation levels established by the RCA, and loss of market share. In reality, ACS is fully recovering its local revenue requirement through existing retail and UNE rates. Even more significantly, ACS' most recent 10-K

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<sup>40</sup> Opposition of Z-Tel Communications, Inc. to Petition for Forbearance of Verizon, CC Docket NO. 01-338 at 19-22 (filed September 3, 2002). As Z-Tel also points out, grant of forbearance here would also raise significant constitutional questions.

<sup>41</sup> ACS January 6 ex parte letter at 11.

<sup>42</sup> *Id.* at 10.

and 10-Q filings at the SEC show that even as it has been losing retail market share to GCI's UNE-based offerings, its local telephone operating company revenue has *increased*. As shown in the chart below, local telephone operating company revenue – which does not include revenue from ACS' highly profitable directory operations, nor ACS' money-losing Internet, long distance and wireless operations – is actually higher now than it was in 1999, the year ACS acquired its Alaska systems.<sup>43</sup>

**ACS Operating Revenue and Access Lines, 1999-2002**

ACS Operating Cos.	1999	2000	2001	2002 (ann.)	Change 1999-2002
Operating Revenue (\$ millions)	\$222	\$222	\$221	\$229	3.12%
Retail Access Lines	281,726	272,936	261,002	241, 583	-14.25%
UNE Lines	28,303	39,221	49,062	60,504	114.54%
Total Local Lines	325,608	329,460	332,923	327,161	0.48%

What ACS' SEC financial statements (as opposed to its rhetoric) also demonstrate is that any ACS financial strain is the result of the fact that it is hemorrhaging cash in its unregulated lines of business (Internet, long distance and wireless) and because it is over-leveraged as a result of taking on too much debt when it paid a substantial premium to acquire its four principal Alaska ILEC operations in 1999. In other words, it is ACS' own business decisions that have placed the company in its existing financial position, not regulatory policy.

ACS was formed through a series of ILEC acquisitions in 1999.<sup>44</sup> When ACS purchased these telephone utilities, it paid \$257 million more than the book value of the assets and borrowed \$612 million to acquire assets worth \$439 million.<sup>45</sup> ACS paid this premium despite the fact that one of the acquired ILECs did not have an exemption from the Act's unbundling obligations pursuant to Section 252(f)(1),<sup>46</sup> GCI's request that rural exemptions for the three other ILEC operations be lifted was pending, and an Alaska court had already overturned the Alaska Commission's prior decision not to lift the rural exemptions. Thus, ACS knowingly paid a premium for telephone utilities that were subject to future competition. Unsurprisingly, ACS is now saddled with debt payments for these purchases.<sup>47</sup> As

<sup>43</sup> Data compiled from ACS' 10-K and 10-Q reports to the Securities and Exchange Commission.

<sup>44</sup> ACS acquired Anchorage Telephone Utility, the non-rural municipally-owned ILEC serving the Anchorage market (now ACS of Alaska, Inc.); Telephone Utilities of Alaska, Inc., the ILEC in Juneau (now ACS of Alaska, Inc.); PTI Communications, Inc., the ILEC in Fairbanks (now ACS of Fairbanks, Inc.); and Telephone Utilities of the North, Inc., the ILEC serving the suburbs of Fairbanks and other, smaller areas of the state (now ACS of the Northland, Inc.).

<sup>45</sup> Snively King Report at 2.

<sup>46</sup> 47 U.S.C. § 252(f)(1).

<sup>47</sup> ACS' interest expense exceeded its operating income each year between 1999 and 2001, and the first nine months of 2002. Snively King Report at 3.

standard ratemaking principles would dictate, ACS also is not permitted to recover the excess paid over book value in regulated rates through an acquisition adjustment.<sup>48</sup>

ACS' ability to pay its debt is undoubtedly made more difficult by large losses from its unregulated lines of business. Several of ACS' unregulated ventures, including its wireless, Internet and long distance businesses, are racking up net losses and have consumed millions of dollars that otherwise would have been available to ACS' local telephone operations.<sup>49</sup> As discussed in the attached report, cash from ACS' telephone and directory services would have covered the company's substantial interest expense during 2001 and 2002.<sup>50</sup> ACS' principal source of cash shortfall has been its unregulated Internet operation, which drew \$10.5 million in cash from the Company in 2000, \$23.2 million in 2001 and \$26.1 million in the first nine months of 2002 (which annualized to a staggering \$38 million for 2002). ACS' assertion that it has "already cut costs dramatically but it cannot continue to provide service and cut costs sufficiently to make up for the loss of revenue" is simply wrong.<sup>51</sup> ACS' local telephone company operations are generating plenty of cash: ACS' decision to limit network investment is the result of its failures in its risky (and unprofitable) Internet venture, not from declining revenue from lines lost to GCI in the form of UNE loops. In fact, it is reasonable to believe that customers are flocking to GCI based on ACS' mismanagement and failure to invest in its local telephone operations.

It is clear that ACS is attempting to use its highly leveraged balance sheet as an excuse to avoid opening its markets under the Act, and more importantly, as a means to recoup its losses from its own unwise business decisions. In reality, ACS is nothing more than a "leveraged buy out gone bad."<sup>52</sup> The worst outcome for Alaska telecommunications consumers would be to limit, or worse yet eliminate, ACS' obligation to comply with the market opening requirements of the Act. This would force Alaska consumers to retain service from a poorly managed telephone company which, in the absence of competition, has no incentive to innovate, reduce prices to costs, or invest in its network.

## **B. The Commission Should Reject ACS' Latest Attack on RCA-Set UNE Rates.**

This Commission should similarly ignore ACS' latest attack on the UNE rates established by the RCA. Less than six months ago, ACS petitioned this Commission to review the legality of the UNE

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<sup>48</sup> Order Holding Procedural Matters in Abeyance; Affirming Oral Cancellation of the Hearing; Accepting Stipulation; and Approving Applications, Subject to Conditions, *In the Matter of the Application Filed by Alaska Communications System, Inc., for Authority To Acquire a Controlling Interest in the Municipality of Anchorage d/b/a Anchorage Telephone Utility a/k/a ATU Telecommunications*, Docket No. U-98-173, Order No. 7 and *In the Matter of the Application Filed by Alaska Communications System, Inc. for Authority To Acquire a Controlling Interest in ATU Long Distance, Inc.*, Docket No. U-98-174, Order No. 7 at 7 (April 9, 1999).

<sup>49</sup> Snavelly King Report at 4.

<sup>50</sup> *Id.*

<sup>51</sup> ACS January 7 ex parte letter at 6.

<sup>52</sup> *Id.* at 6.

rates established by the RCA for Anchorage and Fairbanks, and establish cost-based UNE rates on ACS' own cost study.<sup>53</sup> This Commission appropriately rejected that request on the grounds that the Commission only has authority to preempt a state commission when the state fails to act, not when the petitioning party merely doesn't like the result.<sup>54</sup> With regard to the Fairbanks UNE rates, which ACS again alleges are set below its costs, the Commission found that, "When the question presented is whether a state commission's determination under section 252 was correct on the merits, the remedy for a party seeking review of that determination is with the courts."<sup>55</sup> Thus, any attack on the RCA's UNE rate order should be made in the appropriate forum—federal district court. The Commission also found that the RCA had not failed to act through its handling of ACS' request to review its Anchorage UNE rates, an investigation which ACS has delayed for almost two years based on its failure to file appropriate cost models and its refusal to comply with RCA orders.<sup>56</sup> It appears that ACS is attempting to obtain the same type of relief that this Commission already rejected, though its request adopts a new form: rather than establishing new UNE rates, ACS asks the Commission to eliminate UNEs altogether. Once again, the Commission must reject ACS' attempt at forum shopping, and decline to undertake a review of the RCA's ratemaking decisions.

With regard to the UNE rates themselves, it is clear that they are within the appropriate range of UNE rates established by other state commissions, when comparing ACS' embedded loop cost to the UNE loop rates established by the RCA. GCI has compared state-by-state UNE loop rates compiled nationwide<sup>57</sup> with the NECA-filed embedded loop costs in each of those states, as well as the same relationship with respect to ACS' Anchorage, Fairbanks and Juneau study areas. As demonstrated in Exhibit B, attached, the TELRIC loop rates for Anchorage, Fairbanks and Juneau are right in line with the rest of the country, taking into account relative embedded book costs.<sup>58</sup> ACS' rates are not abnormal outliers. In any event, as previously discussed, migration of consumers from ACS retail services to GCI's UNE-based services is not the source of any ACS financial problems.

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<sup>53</sup> Emergency Petition for Declaratory Ruling and Other Relief of ACS of Anchorage, Inc. and ACS of Fairbanks, Inc., WC Docket No. 02-201 (filed July 24, 2002).

<sup>54</sup> Memorandum Opinion and Order, *In the matter of ACS of Anchorage, Inc. and ACS of Fairbanks, Inc., Emergency Petition for Declaratory Ruling and Other Relief Pursuant to Sections 201(b) and 252(e)(5) of the Communications Act*, WC Docket No. 02-201 (rel. October 22, 2002).

<sup>55</sup> *Id.* at 8.

<sup>56</sup> *Id.* at 5.

<sup>57</sup> Billy Jack Gregg, Director-Consumer Advocate Division, Public Service Commission of West Virginia, "Summary of the Unbundled Network Element Prices in the United States (Updated January 1, 2003)."

<sup>58</sup> Exhibit B.

### **C. ACS' Depreciation Rates Are Reasonable and Fall Within Ranges Set By The FCC.**

ACS also repeatedly attacks the RCA's depreciation rates, complaining that, "regulators have required ACS to take twice as long to depreciate basic telephone cable as GCI takes."<sup>59</sup> According to ACS, "rather than recognize our competitive environment, our increased risk, our need to enhance innovation, regulators are extending, rather than shortening depreciation lives, exacerbating already poor operating conditions."<sup>60</sup> ACS' criticisms are misguided. Competition from GCI will not alter ACS' forward-looking depreciation rates. Depreciation measures the useful life of an asset, not increased financial risk. Indeed, other inputs into the traditional ratemaking model, such as cost of capital, more appropriately take risk into account. The eventual obsolescence of ACS' loops, switches and trunks is not affected by competition from GCI but by much broader technological developments in the industry in loops, switches and trunks. Further, as discussed above, GCI is investing in entirely different network technologies than those utilized by ACS, notably GCI's investment in upgrades to its existing cable plant to provide IP-based cable telephony services. This makes a comparison between ACS' and GCI's respective depreciation lives misleading at best.

Finally, it is important to note that ACS claim that "regulators are extending ... depreciation lives" is a serious distortion of the facts.<sup>61</sup> In Docket No. U-01-85, et al., ACS of Anchorage, Inc. submitted a general rate case with the RCA.<sup>62</sup> On July 2, 2001, the ACS LECs (including ACS of Anchorage, Inc.) submitted a depreciation study in that docket which proposed new rates and net salvage amounts for the majority of the ACS LECs' plant accounts. Subsequently, on March 1, 2001, parties in the case (again, including ACS of Anchorage, Inc.) filed a stipulation concerning cost of capital and pro forma adjustments to the ACS LECs' revenue requirements.<sup>63</sup> All issues but depreciation were settled in that stipulation. Indeed, the RCA's June 6, 2002 order accepted the stipulation, including "the lives, net salvages, and transfers that were not contested by the parties."<sup>64</sup>

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<sup>59</sup> ACS January 7 ex parte letter at 4.

<sup>60</sup> *Id.* at 5.

<sup>61</sup> ACS January 16 ex parte letter at 5.

<sup>62</sup> Order Accepting Stipulation, Affirming Bench Order, Setting Depreciation Rates, Granting Petition for Confidentiality, Setting Procedural Schedule, and Denying Admission of Exhibit 39, *In the Matter of the Investigation of the Local Exchange Revenue-Requirement, Depreciation, Cost-of-Service, and Rate Design Studies for ACS of Alaska, Inc. d/b/a Alaska Communications Systems, ACS Local Services and ACS, et al.*, Docket No. U-01-85, Order No. 11 (June 6, 2002).

<sup>63</sup> *Id.* at 3.

<sup>64</sup> *Id.* at 4.

Careful review of the RCA's June 6, 2002 order reveals that the RCA did not in fact lengthen any of the lives for the ACS LECs' plant accounts. In fact, based on the record and the depreciation study filed by ACS, the RCA either held constant or shortened the reported current lives for ACS of Anchorage, Inc.<sup>65</sup>

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In conclusion, the threat of market share and earnings losses is a natural consequence of opening once-monopoly local telecommunications markets to competitive entry. Faced with real competition, ACS is unveiling a parade of horrors that will result if it is not able to increase UNE rates or avoid existing unbundling requirements, such as the inability to maintain its network, or worse still, being forced into bankruptcy. The Commission must ignore these unfounded threats. Competition enabled by all modes of entry – resale, facilities deployment, and unbundled network elements – is finally providing Alaska consumers with the benefits Congress envisioned in the Act, including improved quality of service, innovative service offerings, and lower retail rates.

Moreover, ACS' claimed precarious fiscal condition is the result of its own business decisions – such as its investment in unprofitable lines of business and acquisition of substantial debt – not competition. ACS' telephone operating company revenue has increased with competition, rather than declining. This Commission should not provide ACS with a special bailout, thereby foreclosing Alaska consumers from enjoying the substantial benefits of local competition based on their misfortune to be served by a poorly managed ILEC. Indeed, assuming that ACS does face further financial difficulties of its own making, it is unbelievable to imagine that an asset as valuable as ACS' telephone operations, which provide access to every telecommunications user in Alaska's three largest markets, would go unused. For the foregoing reasons, GCI urges this Commission to reject ACS' misguided request for relief and instead adopt rules that will ensure that CLECs such as GCI will continue to have nondiscriminatory access to unbundled network elements at reasonable, TELRIC-based rates, consistent with the recommendations contained herein. This will benefit consumer welfare and promote sustainable, facilities-based competition.

Sincerely,



Frederick W. Hitz, III  
Director, Rates and Tariffs  
General Communication, Inc.

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<sup>65</sup> *Id.* at 9, 12, 15, 22, 26. ACS later sought to reopen the record, asserting that its own depreciation study had reported the wrong current service lists to the RCA. October 17, 2002, ACS of Anchorage, Inc.'s Motion to Reopen the Hearing Record to Correct Substantial Evidentiary Errors, Docket U-01-85 et al.